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AGENDA ITEM 7b

TO: MEMBERS OF THE INVESTMENT COMMITTEE

- I. SUBJECT:** Revision of Policy on Credit Enhancement Program
- II. PROGRAM:** Credit Enhancement Program
- III. RECOMMENDATION:** Approve the Revision of Policy on Credit Enhancement by increasing the total aggregate commitment amount from \$5 billion to \$10 billion and eliminating the dollar based transaction limit (Attachment 1)

* (Please refer to Attachment 2 for Wilshire's opinion letter)

IV. BACKGROUND

At the February 2005 Investment Committee meeting, the Board approved the nationwide Credit Enhancement Program (CEP) with an initial commitment of up to five billion dollars. The Program began operating in 2005. The CEP provides credit enhancement to states and municipalities nationwide and has generated over \$1.7 million in revenue over the previous reporting period (January 2006 through December 2006). As of April 30th 2008, the Program has approximately two billion dollars in outstanding commitments.

V. ANALYSIS

The municipal market has recently faced significant turmoil as a result of downgrades of some of the monoline insurance providers and failure of the auction-rate market. As a result, municipalities have found it difficult to secure credit and liquidity enhancement for their debt issuance which has resulted in higher financing costs. For these reasons, staff has seen a significant pick-up in demand for enhancement facilities and an increase in pricing.

Staff recommends increasing the total aggregate commitment amount to \$10 billion. This increase will allow the CEP to increase its commitment size to states and municipalities both in California and nationwide.

The increase from \$5 billion to \$10 billion is within the range that was initially anticipated by staff and the rating agencies when formulating the program. Prior to CEP initiation, staff worked in coordination with the rating agencies, and envisioned that the maximum exposure for the CEP would be approximately 3% to 5% of CalPERS' total assets base. The increase from \$5 billion to \$10 billion in CEP represents approximately 4% of CalPERS' total assets as of April 30th, 2008.

In addition, staff recommends removing the dollar based per transaction limits. The elimination of the dollar based transaction limit is consistent with moving towards percentage based limits that are found throughout CalPERS delegation documents and policies.

All three rating agencies are aware of the increase in CalPERS' total assets and have been consulted and are on board with all of the proposed policy revisions.

VI. RECOMMENDATION

Staff recommends that the Investment Committee approve a revision to the CEP total aggregate commitment size from \$5 billion to \$10 billion and eliminate the dollar based transaction limit of \$250 million. The increase in the proposed program commitment size is based on increased demand for credit enhancement and is in line with the expansion of CalPERS' plan assets. The removal of the dollar based transaction limit is consistent with percentage based limits already embedded in the policy.

Proposed Policy Revision:

- Increase the CEP total aggregate commitment amount from \$5 billion to \$10 billion. (Attachment 1, Section VI.A)
- Eliminate the dollar based transaction limit. (Attachment 1, Section V.G.1)

VII. STRATEGIC PLAN:

This item is consistent with the Strategic Plan, Goal VIII. to manage the risk and volatility of assets and liabilities to ensure sufficient funds are available, first, to pay benefits and second, to minimize and stabilize contributions.

VIII. RESULTS/COSTS:

The Statement of Policy for the Credit Enhancement Program is presented to the Investment Committee for approval. Use of this Policy assures sufficient flexibility in managing investment risks and returns associated with the management and oversight of the Program.

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